



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

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April 25, 2007

Mr. Mark Leary, Executive Director
California Integrated Waste Management Board
1001 I Street, MS-1
P.O. Box 4025
Sacramento, CA 95812-4025

Dear Mr. Leary:

Final Audit Report—California Used Oil Recycling Fees—CITGO Petroleum Corporation

Enclosed is our final audit report on the Used Oil Recycling Fee Returns submitted by CITGO Petroleum Corporation (CITGO) for the period January 1, 2004 through June 30, 2006. The Department of Finance, Office of State Audits and Evaluations, performed this audit under an interagency agreement with the California Integrated Waste Management Board. The scope of our work included a review of reported fees and oil sales, internal control, and compliance with state law.

CITGO was afforded the opportunity to respond to the draft report; however, CITGO chose not to submit a written response. The enclosed final report is for your information and use. We have also sent a copy to CITGO.

If you have any questions regarding this report, please contact Frances Parmelee, Manager, or Rick Cervantes, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Diana L. Ducay, Chief
Office of State Audits and Evaluations

Enclosure

cc: Mr. Tom Estes, Deputy Director, Administration and Finance Division, California Integrated Waste Management Board
Mr. Roger Ikemoto, Grants and Audits Manager, Administration and Finance Division, California Integrated Waste Management Board
Ms. Julie Arico, Accounting Administrator, Administration and Finance Division, California Integrated Waste Management Board
Ms. Bonnie Cornwall, Supervisor, Used Oil and Household Hazardous Waste Unit, California Integrated Waste Management Board
Mr. Rocky Sood, Motor Fuel Tax Manager, CITGO Petroleum Corporation

AN OIL RECYCLING FEE AUDIT

CITGO Petroleum Corporation Used Oil Recycling Fee Returns For the Period January 1, 2004 through June 30, 2006

Prepared By:
Office of State Audits and Evaluations
Department of Finance

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PREFACE

The Department of Finance, Office of State Audits and Evaluations, performed this audit under an interagency agreement with the California Integrated Waste Management Board (Board).

CITGO Petroleum Corporation (CITGO) reported \$1,036,839 in oil recycling fees to the Board for the period January 1, 2004 through June 30, 2006. The objectives of this audit were:

- To determine whether CITGO accurately reported oil sales and computed fees.
- To assess whether CITGO's internal control system allows for the accurate accounting of oil sales subject to the California Oil Recycling Enhancement Act.
- To verify CITGO's compliance with laws and regulations applicable to the California Oil Recycling Enhancement Act.

We did not assess the efficiency or effectiveness of program operations; this responsibility lies with the Board. The responsibility for financial reporting and compliance rests with CITGO.

This report is intended for the information and use of Board and CITGO management. However, the report is a matter of public record and its distribution is not limited.

STAFF:

Susan M. Botkin, CGFM
Manager

Rick Cervantes, CPA
Supervisor

Robert Castillo



INDEPENDENT AUDITOR'S REPORT

Mr. Mark Leary, Executive Director
California Integrated Waste Management Board
1001 I Street, MS-1
P.O. Box 4025
Sacramento, CA 95812-4025

We have audited the accompanying *Schedule of Lubrication Oil Sales, Exempt Transactions, and Fees Owed* and *Schedule of Industrial Oil Sales* (Schedules) with respect to the California Used Oil Recycling Fee Returns submitted by CITGO Petroleum Corporation (CITGO) to the California Integrated Waste Management Board (Board) for the period January 1, 2004 through June 30, 2006. The Schedules were prepared from CITGO's records and are the responsibility of CITGO's management. Our responsibility is to express an opinion on the Schedules based on our audit.

We conducted our audit in accordance with *Generally Accepted Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to provide reasonable assurance as to whether the Schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Schedules. An audit also includes assessing the accounting principles used by management. The accompanying Schedules were prepared as described in Note 3. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the Schedules referred to above present fairly, in all material respects, CITGO's lubrication oil sales, exempt transactions, and fees owed for the period January 1, 2004 through June 30, 2006.

Compliance

As part of obtaining reasonable assurance about whether the Schedules are free of material misstatement, we performed tests of CITGO's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of Schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under *Generally Accepted Government Auditing Standards* and is described in the accompanying schedule of *Finding and Recommendations* section of this report.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered CITGO's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the Schedules and not to provide assurance on the internal control over financial reporting.

However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect CITGO's ability to record, process, summarize, and report financial data consistently with the assertions of management in the Schedules. The reportable condition is described in the *Finding and Recommendations*, section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the Schedules being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, the noted reportable condition is not believed to be a material weakness.

This report is intended solely for the information and use of Board and CITGO management, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record, and its distribution is not limited.

Original signed by:

Janet I. Rosman, CPA
Assistant Chief, Office of State Audits and Evaluations
(916) 322-2985

August 3, 2006

SCHEDULE OF LUBRICATION OIL SALES, EXEMPT TRANSACTIONS, AND FEES OWED

CITGO Petroleum Corporation
For the Period January 1, 2004 through June 30, 2006

	<u>Per Fee Payer Returns</u>	<u>Per CITGO Records</u>	<u>Differences</u>
Sales			
Gross Lubrication Oil Sold (Gallons)	6,534,179	6,677,101	142,922
Less: Exempt Transactions (Gallons)	<u>(53,933)</u>	<u>(196,855)</u>	<u>(142,922)</u>
Total Lubrication Oil Sold (Gallons Subject to Fee)	<u>6,480,246</u>	<u>6,480,246</u>	<u>0</u>
Sales @ \$.16/gallon	<u>\$ 1,036,839</u>	<u>\$ 1,036,839</u>	<u>\$ 0</u>

The accompanying notes are an integral part of this schedule.

SCHEDULE OF INDUSTRIAL OIL SALES

CITGO Petroleum Corporation
For the Period January 1, 2004 through June 30, 2006

	<u>Per Fee Payer Returns</u>	<u>Per CITGO Records</u>	<u>Difference in Gallons</u>
Industrial Oil Sold (Gallons)	3,024,818	2,457,559	567,259

The accompanying notes are an integral part of this schedule.

NOTES TO THE SCHEDULES

CITGO Petroleum Corporation For the Period January 1, 2004 through June 30, 2006

NOTE 1 Description of the Reporting Entity

CITGO Petroleum Corporation (CITGO) is a subsidiary of PDV America, Inc., an indirect wholly owned subsidiary of Petroleos de Venezuela, S.A. ("PDVSA"), the national oil company of the Bolivarian Republic of Venezuela. CITGO manufactures or refines and markets transportation fuels as well as lubricants, refined waxes, petrochemicals, asphalt, and other industrial products.

NOTE 2 General Program Information

The Legislature enacted the California Oil Recycling Enhancement Act (Act) (Public Resources Code, Sections 48600 through 48691) to reduce the illegal disposal of used oil, and to recycle and reclaim used oil in order to recover valuable natural resources, and to avoid damage to the environment and threats to public health.

This Act provides the Board authority to adopt a used oil-recycling program. The Act also gives the Board responsibility and authority to receive quarterly reports from companies selling oil in California. Based on the level of reported oil sales, the companies are required to pay fees to the Board.

The Act describes the Board's process for depositing the fees into the California Used Oil Recycling Fund. Recycling incentive payments are the primary allowable fund appropriations.

NOTE 3 Basis of Presentation

The *Schedule of Lubrication Oil Sales, Exempt Transactions, and Fees Owed*; and the *Schedule of Industrial Oil Sales* (Schedules) were prepared from CITGO's accounting records. These schedules summarize the fees paid, and the lubrication oil sold during the reporting period January 1, 2004 through June 30, 2006. CITGO's reported fees and oil sales were in accordance with the terms and conditions of the Act.

FINDING AND RECOMMENDATIONS

During our audit, we identified a reportable compliance and internal control issue requiring corrective action. The following recommendations, if implemented, will improve the CITGO Petroleum Corporation (CITGO) fiscal controls.

FINDING Incorrect Lubricating and Industrial Oil Sales Reported

Condition: CITGO did not report accurate lubricating and industrial oil sales. A comparison of the amounts reported on the Oil Recycling Fee Returns (returns) with CITGO sales reports and sales invoices found that CITGO underreported lubrication oil sales and overreported industrial oil sales. The following errors were identified:

- Gross and exempt lubricating oil sales totaling 142,922 gallons were not reported on the returns.
- Lubricating oil product IGS, totaling 567,259 gallons, was incorrectly reported as industrial oil sales on the returns.

This finding does not affect the fees owed to the Board.

Criteria: California Public Resources Code (PRC) Section 48616 defines industrial oil as any compressor, turbine or bearing oil, hydraulic oil, metal-working oil, or refrigeration oil.

PRC Section 48618 defines lubrication oil as any oil intended for use in an internal combustion engine crankcase, transmission, gearbox, or differential in an automobile, bus, truck, vessel, plane, train, heavy equipment, or other machinery powered by an internal combustion engine.

California Code of Regulations, Title 14, Section 18622 states that oil manufacturers must report lubricating and industrial oil sold in California.

Recommendations: Ensure that lubricating and industrial oils sales are properly classified in the information system used to prepare sales reports supporting the returns.

Accurately report industrial oil sales, lubricating oil sales, and oil recycling fees on returns submitted.